

BP PRUDHOE BAY ROYALTY TRUST
Form 10-Q
November 07, 2008

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number 1-10243

BP PRUDHOE BAY ROYALTY TRUST

(Exact Name of Registrant as Specified in Its Charter)

Delaware

13-6943724

(State or Other Jurisdiction of Incorporation or
Organization)

(I.R.S. Employer

Identification No.)

The Bank of New York Mellon, 101 Barclay Street,
New York, NY

10286

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: (212) 815-6908

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes No

As of November 7, 2008, 21,400,000 Units of Beneficial Interest were outstanding.

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

BP Prudhoe Bay Royalty Trust
Statement of Assets, Liabilities and Trust Corpus
(Prepared on a modified basis of cash receipts and disbursements)
(In thousands, except unit data)

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------------------|----------------------------------|
| | (Unaudited) | |
| Assets | | |
| Royalty interest, net (Notes 1, 2 and 3) | \$ 4,519 | \$ 6,026 |
| Cash and cash equivalents (Note 2) | 1,001 | 1,009 |
| Total assets | \$ 5,520 | \$ 7,035 |
| Liabilities and Trust Corpus | | |
| Accrued expenses | \$ 224 | \$ 443 |
| Trust corpus (40,000,000 units of beneficial interest authorized, 21,400,000 units issued and outstanding) | 5,296 | 6,592 |
| Total liabilities and trust corpus | \$ 5,520 | \$ 7,035 |

See accompanying notes to financial statements (unaudited).

BP Prudhoe Bay Royalty Trust
Statements of Cash Earnings and Distributions
(Prepared on a modified basis of cash receipts and disbursements)
(Unaudited)
(In thousands, except unit data)

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Royalty revenues | \$ 66,030 | \$ 44,164 | \$ 189,237 | \$ 126,620 |
| Interest income | 3 | 21 | 29 | 61 |
| Less: Trust administrative expenses | (689) | (767) | (1,611) | (1,327) |
| Cash earnings | \$ 65,344 | \$ 43,418 | \$ 187,655 | \$ 125,354 |
| Cash distributions | \$ 65,344 | \$ 43,415 | \$ 187,663 | \$ 125,353 |
| Cash distributions per unit | \$ 3.0535 | \$ 2.0287 | \$ 8.7693 | \$ 5.8576 |
| Units outstanding | 21,400,000 | 21,400,000 | 21,400,000 | 21,400,000 |

See accompanying notes to financial statements (unaudited).

BP Prudhoe Bay Royalty Trust
Statements of Changes in Trust Corpus
(Prepared on a modified basis of cash receipts and disbursements)
(Unaudited)
(In thousands)

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Trust corpus at beginning of period | \$ 5,313 | \$ 7,250 | \$ 6,592 | \$ 8,853 |
| Cash earnings | 65,344 | 43,418 | 187,655 | 125,354 |
| (Increase) decrease in accrued expenses | 486 | 406 | 219 | (191) |
| Cash distributions | (65,344) | (43,415) | (187,663) | (125,353) |
| Amortization of royalty interest | (503) | (502) | (1,507) | (1,506) |
| | | | | |
| Trust corpus at end of period | \$ 5,296 | \$ 7,157 | \$ 5,296 | \$ 7,157 |

See accompanying notes to financial statements (unaudited).

BP Prudhoe Bay Royalty Trust
Notes to Financial Statements (Unaudited)
(Prepared on a Modified Basis of Cash Receipts and Disbursements)
September 30, 2008

(1) Formation of the Trust and Organization

BP Prudhoe Bay Royalty Trust (the Trust), a grantor trust, was created as a Delaware business trust pursuant to a Trust Agreement dated February 28, 1989 (the Trust Agreement) among The Standard Oil Company (Standard Oil), BP Exploration (Alaska) Inc. (BP Alaska), The Bank of New York Mellon (the Trustee) and BNY Mellon Trust of Delaware (successor to The Bank of New York (Delaware)), as co-trustee. Standard Oil and BP Alaska are indirect wholly-owned subsidiaries of BP p.l.c. (BP).

On February 28, 1989, Standard Oil conveyed an overriding royalty interest (the Royalty Interest) to the Trust. The Trust was formed for the sole purpose of owning and administering the Royalty Interest. The Royalty Interest represents the right to receive a per barrel royalty (the Per Barrel Royalty) of 16.4246% on the lesser of (a) the first 90,000 barrels of the average actual daily net production of oil and condensate per quarter or (b) the average actual daily net production of oil and condensate per quarter from BP Alaska's working interest as of February 28, 1989 in the Prudhoe Bay Field situated on the North Slope of Alaska (the BP Working Interests). Trust Unit holders are subject to the risk that production will be interrupted or discontinued or fall, on average, below 90,000 barrels per day in any quarter. BP has guaranteed the performance of BP Alaska of its payment obligations with respect to the Royalty Interest.

The trustees of the Trust are The Bank of New York Mellon, a New York banking corporation, and BNY Mellon Trust of Delaware, a Delaware banking corporation. BNY Mellon Trust of Delaware serves as co-trustee in order to satisfy certain requirements of the Delaware Statutory Trust Act. The Bank of New York Mellon alone is able to exercise the rights and powers granted to the Trustee in the Trust Agreement.

The Per Barrel Royalty in effect for any day is equal to the price of West Texas Intermediate crude oil (the WTI Price) for that day less scheduled Chargeable Costs (adjusted for inflation) and Production Taxes (based on statutory rates then in effect). See Note 5 for information concerning recent changes in Alaska oil and gas production taxes which have affected the calculation of the Per Barrel Royalty.

The Trust is passive, with the Trustee having only such powers as are necessary for the collection and distribution of revenues, the payment of Trust liabilities, and the protection of the Royalty Interest. The Trustee, subject to certain conditions, is obligated to establish cash reserves and borrow funds to pay liabilities of the Trust when they become due. The Trustee may sell Trust properties only (a) as authorized by a vote of the Trust Unit holders, (b) when necessary to provide for the payment of specific liabilities of the Trust then due (subject to certain conditions) or (c) upon termination of the Trust. Each Trust Unit issued and outstanding represents an equal undivided share of beneficial interest in the Trust. Royalty payments are received by the Trust and distributed to Trust Unit holders, net of Trust

BP Prudhoe Bay Royalty Trust
Notes to Financial Statements (Unaudited)
(Prepared on a Modified Basis of Cash Receipts and Disbursements)
September 30, 2008

expenses, in the month succeeding the end of each calendar quarter. The Trust will terminate upon the first to occur of the following events:

- a. On or prior to December 31, 2010: upon a vote of holders of not less than 70% of the outstanding Trust Units.
- b. After December 31, 2010: (i) upon a vote of holders of not less than 60% of the outstanding Trust Units, or (ii) at such time the net revenues from the Royalty Interest for two successive years commencing after 2010 are less than \$1,000,000 per year (unless the net revenues during such period are materially and adversely affected by certain *force majeure* events).

In order to ensure that the Trust has the ability to pay future expenses, the Trust established a cash reserve account, which the Trustee believes is sufficient to pay approximately one year's current and expected liabilities and expenses of the Trust.

(2) Basis of Accounting

The financial statements of the Trust are prepared on a modified cash basis and reflect the Trust's assets, liabilities, corpus, earnings, and distributions, as follows:

- a. Revenues are recorded when received (generally within 15 days of the end of the preceding quarter) and distributions to Trust Unit holders are recorded when paid.
- b. Trust expenses (which include accounting, engineering, legal, and other professional fees, trustees' fees, and out-of-pocket expenses) are recorded on an accrual basis.
- c. Cash reserves may be established by the Trustee for certain contingencies that would not be recorded under generally accepted accounting principles.
- d. Amortization of the Royalty Interest is calculated based on the units of production method. Such amortization is charged directly to the Trust corpus, and does not affect cash earnings. The daily rate for amortization per net equivalent barrel of oil for the three months ended September 30, 2008 and 2007 was \$0.40 and \$0.41, respectively, and for the nine months ended September 30, 2008 and 2007 was \$0.38 and \$0.39, respectively. The Trust evaluates impairment of the Royalty Interest by comparing the undiscounted cash flows expected to be realized from the Royalty Interest to the carrying value, pursuant to Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If the expected future undiscounted cash flows are less than the carrying value, the Trust recognizes an impairment loss for the difference between the carrying value and the estimated fair value of the Royalty Interest.

While these statements differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America, the modified cash

BP Prudhoe Bay Royalty Trust
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September 30, 2008

basis of reporting revenues and distributions is considered to be the most meaningful because quarterly distributions to the Trust Unit holders are based on net cash receipts. These modified cash basis financial statements are unaudited but, in the opinion of the Trustee, include all adjustments necessary to present fairly the assets, liabilities and corpus of the Trust as of September 30, 2008 and 2007, and the modified cash earning and distributions and changes in Trust corpus for the three-month and nine-month periods ended September 30, 2008 and 2007. The adjustments are of a normal recurring nature and are, in the opinion of the Trustee, necessary to fairly present the results of operations.

As of September 30, 2008 and December 31, 2007, cash equivalents which represent the cash reserve consist of U.S. Treasury bills with an initial term of less than three months.

Estimates and assumptions are required to be made regarding assets, liabilities and changes in Trust corpus resulting from operations when financial statements are prepared. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ, and the differences could be material.

These unaudited financial statements should be read in conjunction with the financial statements and related notes in the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2007. The cash earnings and distributions for the interim period presented are not necessarily indicative of the results to be expected for the full year.

(3) Royalty Interest

The Royalty Interest is comprised of the following at September 30, 2008 and December 31, 2007 (in thousands):

| | September 30, 2008 | December 31, 2007 |
|---------------------------------|-----------------------------------|----------------------------------|
| | (Unaudited) | |
| Royalty Interest (at inception) | \$ 535,000 | \$ 535,000 |
| Less: Accumulated amortization | (356,963) | (355,456) |
| Impairment write-down | (173,518) | (173,518) |
| Balance, end of period | \$ 4,519 | \$ 6,026 |

(4) Income Taxes

The Trust files its federal tax return as a grantor trust subject to the provisions of subpart E of Part I of Subchapter J of the Internal Revenue Code of 1986, as amended, rather than as an association taxable as a corporation. The Trust Unit holders are treated as the owners of

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Trust income and corpus, and the entire taxable income of the Trust will be reported by the Trust Unit holders on their respective tax returns.

If the Trust were determined to be an association taxable as a corporation, it would be treated as an entity taxable as a corporation on the taxable income from the Royalty Interest, the Trust Unit holders would be treated as shareholders, and distributions to Trust Unit holders would not be deductible in computing the Trust's tax liability as an association.

The Trustee assumes that some Trust Units are held by a middleman, as such term is broadly defined in the U.S. Treasury Regulations (which includes custodians, nominees, certain joint owners, and brokers holding an interest for a custodian in street name). Therefore, the Trustee considers the Trust to be a widely held fixed investment trust (WHFIT) for U.S. Federal income tax purposes. The Bank of New York Mellon is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT. For information contact The Bank of New York Mellon, Corporate Trust Trustee Administration, 101 Barclay Street, New York, NY 10286, telephone number (212) 815-6908.

(5) Alaska Oil and Gas Production Tax

On August 20, 2006, an amendment to the Alaska oil and gas production tax statutes (the 2006 Tax) became effective. The 2006 Tax replaced an oil production tax levied at the flat rate of 15% of the gross value at the point of production (the wellhead or field value) of taxable oil produced from a producer's leases or properties in the State of Alaska. Under the 2006 Tax, producers were taxed on the production tax value of taxable oil (gross value at the point of production for the calendar year less the producer's direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in Alaska for the year) at a rate equal to the sum of 22.5% plus a progressivity rate determined by the average monthly production tax value of the oil produced. The progressivity portion of the 2006 Tax was equal to 0.25% times the amount by which the simple average for each calendar month of the daily production tax values per barrel of the oil produced during the month exceeded \$40 per barrel.

On December 20, 2007, a further amendment to the Alaska oil and gas production tax statutes (the 2007 Tax) changed the basic tax rate from 22.5% to 25% and increased the progressivity rate. If the producer's average monthly production tax value per barrel is greater than \$30 but not more than \$92.50, the new progressivity tax rate is 0.4% times the amount by which the average monthly production tax value exceeds \$30 per barrel. If the producer's average monthly production tax value per barrel is greater than \$92.50, the progressivity tax rate is the sum of 25% and the product of 0.1% multiplied by the difference between the average monthly production tax value per barrel and \$92.50, except that the sum may not exceed 50%.

BP Prudhoe Bay Royalty Trust
Notes to Financial Statements (Unaudited)
(Prepared on a Modified Basis of Cash Receipts and Disbursements)
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The Trustee and BP Alaska entered into a letter agreement in October 2006 and an amendment thereto in January 2008 (the Letter Agreement) to resolve issues associated with the 2006 Tax and the 2007 Tax. The Letter Agreement modified the calculation of Production Taxes in the daily Per Barrel Royalty calculation effective as of August 20, 2006, in the case of the 2006 Tax, and effective December 20, 2007, in the case of the 2007 Tax.

(6) Legal Expense Contingency

The Trust has incurred, and may continue to incur, legal fees and expenses in amounts which may be significant as a result of litigation and other issues arising out of the August 2006 shutdown of the Prudhoe Bay field. Legal fees and expenses are the principal cause of the increase in Trust administrative expenses for the nine months ended September 30, 2008. Except for legal fees and expenses, the Trustee does not anticipate any other loss contingency resulting from the shutdown of the Prudhoe Bay field.

(7) Royalty Revenue Adjustments

The royalty payments received by the Trust in January 2008, April 2007 and January 2007 with respect to the quarters ended December 31, 2007, March 31, 2007 and December 31, 2006 were adjusted by BP Alaska to compensate for underpayment or overpayment of the royalties due with respect to the quarters ended September 30, 2007, December 31, 2006 and September 30, 2006, respectively. Average net production of crude oil and condensate was less than 90,000 barrels per day during those quarters and royalty payments by BP Alaska with respect to those quarters were based on estimates by BP Alaska of production levels because actual data were not available by the dates on which payments were required to be made to the Trust. Subsequent recalculation by BP Alaska of royalty payments due based on actual production data resulted in the payment adjustments shown in the table below (in thousands):

| | Payment Received | | |
|---|-------------------------|------------------|------------------|
| | Jan. 2008 | Apr. 2007 | Jan. 2007 |
| Royalty payment as calculated | \$65,284 | \$39,297 | \$41,470 |
| Adjustment for previous quarter's (overpayment) underpayment, plus accrued interest | 64 | (47) | 1,736 |
| Net payment received | \$65,348 | \$39,250 | \$43,206 |

Item 2. Trustee's Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Statement

This report contains forward looking statements (that is, statements anticipating future events or conditions and not statements of historical fact). Words such as anticipate, expect, believe, intend, plan or project, and should could, potentially, possibly or may, and other words that convey uncertainty of future events or outcomes are intended to identify forward-looking statements. Forward-looking statements in this report are subject to a number of risks and uncertainties beyond the control of the Trustee. These risks and uncertainties include such matters as future changes in oil prices, oil production levels, economic activity, domestic and international political events and developments, legislation and regulation, and certain changes in expenses of the Trust.

The actual results, performance and prospects of the Trust could differ materially from those expressed or implied by forward-looking statements. Descriptions of some of the risks that could affect the future performance of the Trust appear in Item 1A, Risk Factors, of the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the 2007 Annual Report). There may be additional risks of which the Trustee is unaware or which are currently deemed immaterial.

In the light of these risks, uncertainties and assumptions, you should not rely unduly on any forward-looking statements. Forward-looking events and outcomes discussed in the 2007 Annual Report and in this report may not occur or may transpire differently. The Trustee undertakes no obligation to update forward-looking statements after the date of this report, except as required by law, and all such forward-looking statements in this report are qualified in their entirety by the preceding cautionary statements.

Liquidity and Capital Resources

The Trust is a passive entity. The Trustee's activities are limited to collecting and distributing the revenues from the Royalty Interest and paying liabilities and expenses of the Trust. Generally, the Trust has no source of liquidity and no capital resources other than the revenue attributable to the Royalty Interest that it receives from time to time. See the discussion under THE ROYALTY INTEREST in Part I, Item 1 of the 2007 Annual Report for a description of the calculation of the Per Barrel Royalty, and the discussion under THE PRUDHOE BAY UNIT AND FIELD Reserve Estimates and INDEPENDENT OIL AND GAS CONSULTANTS REPORT in Part I, Item 1 of the 2007 Annual Report for information concerning the estimated future net revenues of the Trust. However, the Trustee has a limited power to borrow, establish a cash reserve, or dispose of all or part of the Trust Estate, under limited circumstances pursuant to the terms of the Trust Agreement. See the discussion under THE TRUST in Part I, Item 1 of the 2007 Annual Report.

Since 1999, the Trustee has maintained a \$1,000,000 cash reserve to provide liquidity to the Trust during any future periods in which the Trust does not receive a distribution. The Trustee will draw funds from the cash reserve account during any quarter in which the quarterly distribution received by the Trust does not exceed the liabilities and expenses of the Trust, and

will replenish the reserve from future quarterly distributions, if any. The Trustee anticipates that it will keep this cash reserve program in place until termination of the Trust.

Amounts set aside for the cash reserve are invested by the Trustee in U.S. government or agency securities secured by the full faith and credit of the United States. Interest income received by the Trust from the investment of the reserve fund is added to the distributions received from BP Alaska and paid to the holders of Units on each Quarterly Record Date.

As discussed under **CERTAIN TAX CONSIDERATIONS** in Part I, Item 1 of the 2007 Annual Report, amounts received by the Trust as quarterly distributions are income to the holders of the Units, (as are any earnings on investment of the cash reserve) and must be reported by the holders of the Units, even if such amounts are used by the Trustee to repay borrowings or replenish the cash reserve and are not received by the holders of the Units.

Results of Operations

Relatively modest changes in oil prices significantly affect the Trust's revenues and results of operations. Crude oil prices are subject to significant changes in response to fluctuations in the domestic and world supply and demand and other market conditions as well as the world political situation as it affects OPEC and other producing countries. The effect of changing economic conditions on the demand for and supply of energy throughout the world and future prices of oil cannot be accurately projected.

Under the terms of the Conveyance of the Royalty Interest to the Trust, the Per Barrel Royalty for any day is the WTI Price for the day less the sum of (i) Chargeable Costs multiplied by the Cost Adjustment Factor and (ii) Production Taxes. The narrative under the captions **THE TRUST Trust Property** and **THE ROYALTY INTEREST** in the 2007 Annual Report explains the meanings of the terms **Conveyance**, **Royalty Interest**, **Per Barrel Royalty**, **WTI Price**, **Chargeable Costs** and **Cost Adjustment Factor** and should be read in conjunction with this report.

Royalty revenues are generally received on the fifteenth day of the month following the end of the calendar quarter in which the related Royalty Production occurred (the **Quarterly Record Date**). The Trustee, to the extent possible, pays all accrued expenses of the Trust on each Quarterly Record Date from the royalty payment received. Revenues and Trust expenses presented in the statement of cash earnings and distributions are recorded on a modified cash basis and, as a result, royalty revenues and distributions shown in such statements for the three-month and nine-month periods ended September 30, 2008 and 2007, respectively, are attributable to BP Alaska's operations during the three-month and nine-month periods ended June 30, 2008 and 2007, respectively.

The following table summarizes the factors which determined the Per Barrel Royalties used to calculate the payments received by the Trust in January, April and July 2008 and 2007 (see Note 1 of Notes to Financial Statements (Unaudited) in Part I, Item 1). The information in the table has been furnished by BP Alaska.

| Royalty Payment in | Is Based on Data for Quarter Ended | Data for Quarter | | | | | |
|--------------------|------------------------------------|-------------------|------------------|-------------------|---------------------------|--------------------------|---|
| | | Average WTI Price | Chargeable Costs | Adjustment Factor | Adjusted Chargeable Costs | Average Production Taxes | Average Per Barrel Royalty ⁽¹⁾ |
| Jul. 2008 | 06/30/2008 | \$124.34 | \$13.00 | 1.668 | \$21.68 | \$52.37 ⁽²⁾ | \$50.29 ⁽³⁾ |
| Apr. 2008 | 03/31/2008 | 97.78 | 13.00 | 1.630 | 21.19 | 33.58 ⁽²⁾ | 43.01 |
| Jan. 2008 | 12/31/2007 | 90.93 | 12.75 | 1.618 | 20.63 | 22.29 | 48.01 |
| Jul. 2007 | 06/30/2007 | 65.02 | 12.75 | 1.601 | 20.42 | 10.59 | 34.00 ⁽³⁾ |
| Apr. 2007 | 03/31/2007 | 58.17 | 12.75 | 1.567 | 19.98 | 8.66 | 29.54 |
| Jan. 2007 | 12/31/2006 | 60.17 | 12.50 | 1.552 | 19.39 | 9.31 | 31.46 ⁽³⁾ |

(1) The average daily net production of oil and condensate from the BP Working Interests exceeded 90,000 barrels per day during the quarter unless otherwise indicated.

(2) Production Taxes reflect the application during the full quarter of the 2007 amendment to the Alaska oil and gas production tax statutes. See Alaska Oil and Gas Production Tax Changes below.

(3) Royalty Production was calculated on the basis of a

preliminary
estimate of
87,855 barrels
of average daily
net production
in the quarter
ended June 30,
2008; 86,917
barrels in the
quarter ended
June 30, 2007
and 87,221
barrels in the
quarter ended
December 31,
2006.

Royalty Production for each day in a calendar quarter is 16.4246% of the first 90,000 barrels of the actual average daily net production of oil and condensate for the quarter from the BP Working Interests. So long as BP Alaska's average daily net production from the BP Working Interests exceeds 90,000 barrels, the principal factors affecting the Trust's revenues and distributions to Unit holders are changes in WTI Prices, scheduled annual increases in Chargeable Costs, changes in the Consumer Price Index and changes in Production Taxes. Average daily net production of oil and condensate from the BP Working Interests has been below 90,000 barrels per day during certain quarterly periods since 2006, due to a BP Alaska program of field wide infrastructure renewal, pipeline replacement and well mechanical improvements.

BP Alaska estimates Royalty Production from the BP Working Interests for purposes of calculating quarterly royalty payments to the Trust because complete actual field production data for the preceding calendar quarter generally is not available by the Quarterly Record Date. To the extent that average net production from the BP Working Interests is below 90,000 barrels per day in any quarter, recalculation by BP Alaska of actual Royalty Production data may result in revisions of prior Royalty Production estimates. Revisions by BP Alaska of its Royalty Production calculations cause BP Alaska to adjust its quarterly royalty payments to the Trust to compensate for overpayments or underpayments of royalties with respect to prior quarters. Such adjustments, if material, may adversely affect certain Unit holders who buy or sell Units between the Quarterly Record Dates for the Quarterly Distributions affected. The Quarterly Distributions received by the Trust from BP Alaska in January 2008, April 2007 and January 2007 were adjusted by BP Alaska to compensate for underpayment or overpayment of royalties due to the Trust with respect to the quarters ended December 31, 2007, March 31,

2007 and December 31, 2006, respectively. See Note 7 of Notes to Financial Statements (Unaudited) in Item 1. Because the statements of cash earnings and distributions of the Trust are prepared on a modified cash basis, royalty revenues for the nine-month periods ended September 30, 2008 and 2007 reflect the amounts of the adjustments with respect to the earlier fiscal periods.

Alaska Oil and Gas Production Tax Changes

In August 2006, Alaska adopted a new oil and gas production tax (the 2006 Tax) which replaced an oil production tax levied at the flat rate of 15% of the gross value at the point of production of taxable oil produced from a producer's leases or properties in the State of Alaska. Under the 2006 Tax, producers were taxed on the production tax value of taxable oil (gross value at the point of production for the calendar year less the producer's direct costs of exploring for, developing, or producing oil or gas deposits located within the producer's leases or properties in Alaska (Lease Expenditures) for the year) at a rate equal to the sum of 22.5% plus a progressivity rate determined by the average monthly production tax value of the oil produced. The progressivity portion of the 2006 Tax was equal to 0.25% times the amount by which the simple average for each calendar month of the daily production tax values per barrel of the oil produced during the month exceeded \$40 per barrel. In addition, the 2006 Tax increased the surcharge on oil produced from leases or properties in Alaska from \$0.03 to \$0.04 per barrel.

On December 20, 2007, a further amendment to the Alaska oil and gas production tax statutes (the 2007 Tax) took effect. The 2007 Tax changes the basic tax rate from 22.5% to 25% and increases the progressivity rate. If the producer's average monthly production tax value per barrel is greater than \$30 but not more than \$92.50, the new progressivity tax rate is 0.4% times the amount by which the average monthly production tax value exceeds \$30 per barrel. If the producer's average monthly production tax value per barrel is greater than \$92.50, the progressivity tax rate is the sum of 25% and the product of 0.1% multiplied by the difference between the average monthly production tax value per barrel and \$92.50, except that the sum may not exceed 50%.

In order to resolve uncertainties in the interpretation of the Conveyance resulting from adoption of the 2006 Tax, in October 2006 the Trustee entered into a letter agreement with BP Alaska (the 2006 Letter Agreement), a copy of which is incorporated by reference as Exhibit 4.5 to this report. The 2006 Letter Agreement sets forth principles agreed to by BP Alaska and the Trustee to resolve how the amount of tax chargeable against the Royalty Interest was to be determined under the Conveyance and the extent to which the retroactivity of the tax legislation was to be recognized for purposes of the Conveyance (the Consensus Principles). In December 2007, BP Alaska notified the Trustee that the adoption of the 2007 Tax made it necessary to modify the Consensus Principles to give effect to the new tax rates. After determining that the proposed changes to the Consensus Principles were consistent with the changes in tax rates effected by the 2007 Tax, on January 11, 2008 the Trustee executed a letter agreement dated December 21, 2007 with BP Alaska (the 2008 Letter Agreement) which supplements and amends the 2006 Letter Agreement and which is incorporated by reference as Exhibit 4.6 to this report.

The following paragraphs describe how the Consensus Principles provide for the amount of Production Taxes (other than the \$0.04 per barrel surcharge) to be determined under the 2006

Tax (from August 20, 2006 through December 19, 2007) and under the 2007 Tax (from December 20, 2007 and thereafter):

- (a) The production tax value per barrel of oil for each day is determined by taking the WTI Price for that day and subtracting the product of the amount of the Chargeable Costs then in effect multiplied by the applicable Cost Adjustment Factor.
- (b) The tax rate for the *progressivity* portion of the tax equals:

| 2006 Tax | 2007 Tax |
|--|---|
| (i) zero, if the simple average of the daily taxable values per barrel under (a) above for a calendar month is not greater than \$40 per barrel; or | (i) zero, if the simple average of the daily taxable values per barrel under (a) above for a calendar month is not greater than \$30 per barrel; |
| (ii) 0.25% times the amount by which the simple average for each calendar month of the daily production tax values per barrel of oil under (a) above, exceeds \$40 per barrel. | (ii) 0.4% times the amount by which the simple average of the taxable values per barrel under (a) above for a calendar month exceeds \$30 per barrel if that average is not greater than \$92.50 per barrel; or |
| | (iii) the sum of 25% plus 0.1% times the amount by which the simple average of the taxable values per barrel under (a) above for a calendar month exceeds \$92.50, except that such sum may not exceed 50%. |
| (c) The amount of Production Tax chargeable against the Royalty Interest equals the taxable value per barrel under (a) above times the Royalty Production under the Conveyance, times a rate equal to the sum of the <i>progressivity</i> rate determined under (b) above plus the following percentage: | |

2006 Tax
22.5%

2007 Tax
25%

*Three Months Ended September 30, 2008 Compared to
Three Months Ended September 30, 2007*

As explained above, Trust royalty revenues received during the third quarter of the fiscal year are based on Royalty Production during the second quarter of the fiscal year. Royalty revenues received by the Trust in the quarter ended September 30, 2008 increased approximately 50% from the corresponding quarter of 2007, reflecting a 91% period-to-period increase in the Average WTI Price from \$65.02 per barrel during the quarter ended June 30, 2007 to \$124.34

per barrel during the quarter ended June 30, 2008. The average Per Barrel Royalty, however, increased by only 48%, principally due to a 395% period-to-period increase in average Production Taxes which rose from \$10.59 per barrel in the quarter ended June 30, 2007 to \$52.37 per barrel in the quarter ended June 30, 2008 as a consequence of the progressivity feature and higher tax rates of the 2007 Tax. Trust administrative expenses decreased 10% in the quarter ended September 30, 2008 from the corresponding period in 2007, primarily due to lower legal fees and expenses related to issues arising from the August 2006 shutdown of the Prudhoe Bay field.

*Nine Months Ended September 30, 2008 Compared to
Nine Months Ended September 30, 2007*

Trust royalty revenues increased 49% in the nine months ended September 30, 2008 from the corresponding period of 2007, reflecting the cumulative effect of a 71% increase in the Average WTI Price during the nine-month period ended June 30, 2008 from the nine-month period ended June 30, 2007. The average Per Barrel Royalty payable with respect to the nine months ended June 30, 2008 received the brunt of the new Alaska oil and gas production taxes and increased by only 49%, as a consequence of both the progressivity feature of the 2006 Tax and 2007 Tax and the higher 2007 Tax rates which became applicable during the latter part of December 2007. Average Production Taxes chargeable with respect to the nine-month period ended June 30, 2008 increased 279% over the average Production Taxes chargeable with respect to the nine months ended June 30, 2007. Trust administrative expenses were 21% higher during the nine months ended September 30, 2007 than in the corresponding period in 2007, primarily due to on-going legal fees and expenses related to issues arising from the August 2006 shutdown of the Prudhoe Bay field.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Trust is a passive entity and except for the Trust's ability to borrow money as necessary to pay liabilities of the Trust that cannot be paid out of cash on hand, the Trust is prohibited from engaging in borrowing transactions. The Trust periodically holds short-term investments acquired with funds held by the Trust pending distribution to Unit holders and funds held in reserve for the payment of Trust expenses and liabilities. Because of the short-term nature of these investments and limitations on the types of investments which may be held by the Trust, the Trust is not subject to any material interest rate risk. The Trust does not engage in transactions in foreign currencies which could expose the Trust or Unit holders to any foreign currency related market risk or invest in derivative financial instruments. It has no foreign operations and holds no long-term debt instruments.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

The Trustee has disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. These controls and procedures include

but are not limited to controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Exchange Act is accumulated and communicated to the responsible trust officers of the Trustee to allow timely decisions regarding required disclosure.

Under the terms of the Trust Agreement and the Conveyance, BP Alaska has significant disclosure and reporting obligations to the Trust. BP Alaska is required to provide the Trust such information concerning the Royalty Interest as the Trustee may need and to which BP Alaska has access to permit the Trust to comply with any reporting or disclosure obligations of the Trust pursuant to applicable law and the requirements of any stock exchange on which the Units are listed. These reporting obligations include furnishing the Trust a report by February 28 of each year containing all information of a nature, of a standard and in a form consistent with the requirements of the SEC respecting the inclusion of reserve and reserve valuation information in filings under the Exchange Act and with applicable accounting rules. The report is required to set forth, among other things, BP Alaska's estimates of future net cash flows from proved reserves attributable to the Royalty Interest, the discounted present value of such proved reserves, the assumptions utilized in arriving at the estimates contained in the report, and the estimate of the quantities of proved reserves (including reductions of proved reserves as a result of modification of BP Alaska's estimates of proved reserves from prior years) added during the preceding year to the total proved reserves allocated to the BP Working Interests as of December 31, 1987.

In addition, the Conveyance gives the Trust and its independent accountants certain rights to inspect the books and records of BP Alaska and discuss the affairs, finances and accounts of BP Alaska relating to the BP Working Interests with representatives of BP Alaska; it also requires BP Alaska to provide the Trust with such other information as the Trustee may reasonably request from time to time and to which BP Alaska has access.

The Trustee's disclosure controls and procedures include ensuring that the Trust receives the information and reports that BP Alaska is required to furnish to the Trust on a timely basis, that the appropriate responsible personnel of the Trustee examine such information and reports, and that information requested from and provided by BP Alaska is included in the reports that the Trust files or submits under the Exchange Act.

As of the end of the period covered by this report, the trust officers of the Trustee responsible for the administration of the Trust conducted an evaluation of the Trust's disclosure controls and procedures. Their evaluation considered, among other things, that the Trust Agreement and the Conveyance impose enforceable legal obligations on BP Alaska, and that BP Alaska has provided the information required by those agreements and other information requested by the Trustee from time to time on a timely basis. The officers concluded that the Trust's disclosure controls and procedures are effective.

Internal Control Over Financial Reporting

There has not been any change in the Trust's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the Trust's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

Item 4T. Controls and Procedures.

Not applicable.

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

(a) On October 15, 2008 the Trust received a cash distribution of approximately \$63,061,000 from BP Alaska with respect to the quarter ended September 30, 2008 (including approximately \$1,632,000 to compensate the Trust for underpayment of the distribution due in July 2008). On October 17, 2008, after adding interest income received from investment of the cash reserve and deducting Trust administrative expenses, the Trustee distributed approximately \$62,862,000 (approximately \$2.94 per Unit) to Unit holders of record on October 14, 2008 (Form 8-K, Item 8.01).

(b) Not applicable.

Item 6. Exhibits.

- 4.1 BP Prudhoe Bay Royalty Trust Agreement dated February 28, 1989 among The Standard Oil Company, BP Exploration (Alaska) Inc., The Bank of New York, Trustee, and F. James Hutchinson, Co-Trustee.
- 4.2 Overriding Royalty Conveyance dated February 27, 1989 between BP Exploration (Alaska) Inc. and The Standard Oil Company.
- 4.3 Trust Conveyance dated February 28, 1989 between The Standard Oil Company and BP Prudhoe Bay Royalty Trust.
- 4.4 Support Agreement dated as of February 28, 1989 among The British Petroleum Company p.l.c., BP Exploration (Alaska) Inc., The Standard Oil Company and BP Prudhoe Bay Royalty Trust.

- 4.5 Letter agreement executed October 13, 2006 between BP Exploration (Alaska) Inc. and The Bank of New York, as Trustee.
- 4.6 Letter agreement executed January 11, 2008 between BP Exploration (Alaska) Inc. and The Bank of New York, as Trustee.
- 31 Rule 13a-14(a)/15d-14(a) Certification.
- 32 Section 1350 Certification.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BP PRUDHOE BAY ROYALTY TRUST

By: THE BANK OF NEW YORK MELLON,
as Trustee

By: /s/ Remo Reale

Remo Reale
Vice President

Date: November 7, 2008

The registrant is a trust and has no officers or persons performing similar functions. No additional signatures are available and none have been provided.

INDEX TO EXHIBITS

| Exhibit No. | Exhibit Description |
|--------------------|---|
| 4.1 | BP Prudhoe Bay Royalty Trust Agreement dated February 28, 1989 among The Standard Oil Company, BP Exploration (Alaska) Inc., The Bank of New York, Trustee, and F. James Hutchinson, Co-Trustee. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (File No. 1-10243). |
| 4.2 | Overriding Royalty Conveyance dated February 27, 1989 between BP Exploration (Alaska) Inc. and The Standard Oil Company. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (File No. 1-10243). |
| 4.3 | Trust Conveyance dated February 28, 1989 between The Standard Oil Company and BP Prudhoe Bay Royalty Trust. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (File No. 1-10243). |
| 4.4 | Support Agreement dated as of February 28, 1989 among The British Petroleum Company p.l.c., BP Exploration (Alaska) Inc., The Standard Oil Company and BP Prudhoe Bay Royalty Trust. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (File No. 1-10243). |
| 4.5 | Letter agreement executed October 13, 2006 between BP Exploration (Alaska) Inc. and The Bank of New York, as Trustee. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (File No. 1-10243). |
| 4.6 | Letter agreement executed January 11, 2008 between BP Exploration (Alaska) Inc. and The Bank of New York, as Trustee. Incorporated by reference to the correspondingly numbered exhibit to the Registrant's Current Report on Form 8-K dated January 11, 2008 (File No. 1-10243). |
| 31* | Rule 13a-14(a) certification. |
| 32* | Section 1350 certification. |

* Filed herewith.